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SUBJECT: POU CHEN GROUP FOCUSES ON CHINA'S RETAIL MARKET AND LOOKS ELSEWHERE FOR MANUFACTURING OPPORTUNITIES

1. (SBU) Summary. As widely reported in the Taiwan press, Taiwanese businessmen have largely greeted President Chen's exhortation to avoid excessive focus on the mainland either negatively or dismissively. However, according to Chi Jui Tsai, Chairman of Pou Chen Group, the world's largest shoe

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manufacturer, increasing costs of doing business in China will lead many Taiwanese concerns to focus on other locales for manufacturing, while devoting more attention to China's retail market. While this will match Chen's exhortations, Tsai emphasized that it would result from market rather than

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political concerns. End Summary.

2. (U) Numerous business leaders in Southern Taiwan have expressed increasing frustration with the Chen administration's lack of progress in cross-strait relations. Chi Mei Group's Optoelectronics and Chilin division vice-presidents, Jack Lin and Richard Soong say that current investment regulations are needlessly complex and burdensome and while they hamper investment on the mainland, they do nothing to encourage investment in Taiwan. Chen's recent announcements concerning the National Unification Council and his exhortation to invest in Taiwan, even at the cost of substantial profits have, in the opinions of Lin and Soong, only served to bring needless attention to their mainland operations. Various other industrial leaders have voiced similar complaints. Tommy Hong, chief of American President Line's Kaohsiung operations said that substantial opening in cross-strait operations is critical to the continued viability of Kaohsiung Harbor. C.J. Tsai, Chairman of Pou Chen Group said that, while he agrees with the general sentiment that the Chen administration's performance in cross-strait relations has been unhelpful, market forces within China will lead his company and many other manufacturing concerns to look beyond China for expansion of their manufacturing operations, regardless of political concerns.

3. (U) As China's economy continues its rapid growth, Pou Chen Group, through its Yue Yuen Industrial Holdings operation in Hong Kong, has changed its China focus from manufacturing to retailing, wholesaling and logistics. Mr. Tsai told AIT/K that the rapidly increasing costs of land

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and labor will lead manufacturers to look elsewhere. However, increasing disposable income will, in Mr. Tsai's estimation, soon deliver on the promise of a robust Chinese consumer market. He said that his company's business strategy will take into account both of these realities.

4. (U) Mr. Tsai believes the rapid development of China's freeway system will quickly make road transportation the most effective means for delivery within China. In light of this, Yue Yuen entered into a joint venture with Hutchison to establish a logistics arm within China. According to Mr. Tsai, the company expects to be well positioned to take

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advantage of increasing industrialization of China's interior by providing services to other manufacturers. Moreover, the company will allow Yue Yuen to meet the delivery needs of its rapidly expanding retail operations in China.

5. (U) Hoping to capitalize on both the increasing amount of disposable income within China, as well as a fitness craze prompted by the 2008 Olympics, Pou Chen Group has established more than one thousand retail outlets within China to market athletic apparel and shoes within China. The outlets will operate under the brand "Footzone" and will carry products for which Pou Chen is the lead manufacturer, including such brands as Nike, Adidas, Reebok and Timberland. Most of the clothing will be produced by Yuen Thai, a joint venture controlled by Pou Chen. This will

give the retail outlets access to Nike, Ralph Lauren and Liz Claiborne lines among others. Additionally, Pou Chen Group will be establishing a chain of fitness centers throughout China, the first twenty-two of which are expected to begin operations by the end of this year.

16. (SBU) While Mr. Tsai said that manufacturing operations within China will continue (Pou Chen employs more than 400,000 people in its China plants), along with those in Indonesia, Hungary, Mexico and the United States, the price of labor and real estate will lead his company to develop increased capacity elsewhere. The company has looked closely at a number of countries including Vietnam, Indonesia, India, the Philippines and even Mongolia, but has decided that their major manufacturing effort going forward will concentrate on Bangladesh. Mr. Tsai said that over the longer term his company will look closely at Mongolia as well as the interior of China. However, he said that western China suffered too much social instability to be a viable choice at present.

17. (SBU) Mr. Tsai said that India and Bangladesh were the final two candidates for immediate expansion. His company settled on Bangladesh largely because of dissatisfaction with India's factory regulations. He said that India's regulatory environment is overly restrictive in terms of factory size and number of employees. Given this, his company would need to open three factories in India to accomplish what can be done with one factory in Bangladesh.

18. (SBU) According to Mr. Tsai, his company will follow the same top-to-bottom business model in Bangladesh that they used in China. Noting that Bangladesh is about where China was two decades ago in terms of infrastructure, Mr. Tsai said his company expects to develop roads as well as

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power and water supplies to support not only its own operations, but those of other companies that decide to locate in the region. Pou Chen was one of the first Taiwan companies to establish a major presence in China, and through its Yue Yuen Holdings it has experience in developing power plants, water plants and a variety of other infrastructure needs.

19. (SBU) Mr. Tsai said that he is more concerned about U.S.-China relations than Taiwan-China relations. He expressed worry that a disagreement between China and the U.S. over the handling of the Iran problem could adversely influence world oil prices. He also expressed concern over the level of the U.S. dollar, as Pou Chen Group does more than two billion dollars worth of business per year with U.S. companies.

10. (U) Pou Chen Group, while largely producing outside of Taiwan, has still made substantial investments in Taiwan, recently opening new headquarters and an R&D facility in Taichung. Again, Mr. Tsai emphasized that this was a business decision and had nothing to do with politics. He pointed out that his company, in addition to being the largest manufacturer of finished shoes, is also the largest producer of shoe making materials. Moreover, he noted that Pou Chen does the design work for Nike's top end shoe lines. The need to protect proprietary data was the key to making the decision. In Mr. Tsai's opinion, Taiwanese labor and land are cost prohibitive for most low tech manufacturing, but for cutting edge technology, the ability to protect proprietary technology makes Taiwan a good option.

11. (SBU) Comment. AIT/K considers Mr. Tsai's views of China's business conditions to be extremely reliable. He was one of the very first Taiwanese to establish himself on the mainland. AIT/K will report further on the China-related plans of Chi Mei, various shipping concerns, and Southern Taiwan's steel producers by septel. End Comment

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Keegan